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No. 1188

# In the Supreme Court of the United States

*October Term, 1944.*

SUNRAY OIL COMPANY, *Petitioner,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE.

## Petition for Writ of Certiorari, and Brief in Support Thereof.

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| *Point Two.* Petitioner is entitled under Article 22(a)-5 of Treasury Regulations 94, 101 and 103 (19.22(a)-5) to subtract from the amounts received by it from the sale of oil and gas purchased from the lessor by the payment of bonuses or advance royalties, the portion of such bonuses or advance royalties allocable to current production which represent the cost to petitioner of such oil and gas. Petitioner is not permitted or required to recover the cost of such purchased oil and gas through deductions for depletion | 10 |
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IN THE SUPREME COURT OF THE UNITED STATES.
*October Term, 1944.*

No. .....

SUNRAY OIL COMPANY, *Petitioner,*
*vs.*
COMMISSIONER OF INTERNAL REVENUE.

## PETITION FOR WRIT OF *CERTIORARI* TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

*To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:*

Sunray Oil Company prays that a writ of *certiorari* issue to revise the judgment of the Circuit Court of Appeals for the Tenth Circuit, entered in the above case on February 21, 1945, affirming the decision of the Tax Court of the United States.

### Opinions Below.

The opinion of the Tax Court (R. 100) is reported in 3 T. C. 251. The opinion of the Circuit Court of Appeals (R. 227) is not yet reported.

### Summary and Short Statement of Matters Involved.

The Commissioner of Internal Revenue determined deficiencies in petitioner's federal income taxes for the years 1936, 1937, 1938, and 1939, based on two questions here in controversy.

*(1)* The Commissioner included in petitioner's gross income subject to tax, income received by petitioner from the sale of oil and gas produced from wells upon lands owned by the State of Oklahoma and leased to petitioner, said lands being dedicated to, and used exclusively and solely for, governmental purposes of the State of Oklahoma. (See Appendix B, *infra*, p. 17)

*(2)* The Commissioner refused to exclude from petitioner's sales of oil and gas the cost of oil and gas purchased by petitioner from lessors of oil and gas properties represented by the advance payments made therefor by petitioner as lessee to the lessors of such property, contrary to the provisions of Article 22(a)-5 of Treasury Regulations 94, 101, and 103 (19.22(a)-5.)

The Tax Court and the Circuit Court of Appeals sustained the Commissioner's determination on both these points.

The two questions for consideration by the United States Supreme Court are hereby presented.

*(1)* Whether petitioner is entitled to exemption from federal income, taxes, up to March 7, 1938, of its portion of the income from oil and gas leases on State-owned lands, upon the ground that the decision in *Helvering* v. *Mountain Producers Corporation*, 303 U. S. 376, should, as to petitioner, be given a prospective application only, thereby relieving petitioner from undue hardship and injustice.

*(2)* Whether the part of the lease bonuses or advance royalties paid by the petitioner as lessee to lessors of oil and gas properties, who retained an economic interest in the oil and gas in place, represented cost to the petitioner of oil and gas purchased from the lessors' retained share in current production, which should be excluded or eliminated from gross sales in determining gross income as provided in Art. 22(a)-5 of Regulations 94, 101 and 103 (19.22(a)-5.)

**Jurisdiction.**

The judgment of the Circuit Court of Appeals was entered on February 21, 1945 (R. 227). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

**Statutes Involved.**

The statutes and regulations involved are set forth in Appendix A, *infra*, p. 17.

**Specification of Errors to Be Urged.**

*(1)* The Circuit Court of Appeals erred in holding, in effect, that the *Mountain Producers Corporation* case must be given retrospective application as to this petitioner.

*(2)* The Circuit Court of Appeals erred in holding that where petitioner as lessee paid bonuses or advance royalties to lessors "for oil and gas to be extracted," the lessors retaining an economic interest in oil and gas in place, petitioner could not exclude from the amounts received by it from the sale of oil and gas produced under such leases the portion of such bonus or advance royalties allocable to current production of "such oil and gas to be extracted" as the cost to petitioner of such oil and gas; and erred in holding that petitioner could recover its cost of such oil and gas only through deductions for depletion.

**Reasons for Granting Writ.**

*(1)* The proposition that the decisions of the Supreme Court of the United States may or should be given a prospective effect when injustice and undue hardship will thereby be avoided, has never been decided by this Court. The effect of the decision by the Circuit Court of Appeals of the Tenth Circuit, sought herein to be reviewed, is against this proposition. The decision of the United States Court of Appeals of the District of Columbia in *Warring* v. *Colpoys*, 122 F. (2d) 642, 646, is that a decision of the Supreme Court may be applied prospectively, and was a proper consideration for the Circuit Court.

*(2)* The decision of the Circuit Court of Appeals that bonuses or advance royalties paid by the lessee constitute an investment by the lessee in a depletable economic interest in the oil and gas property and not the purchase price of oil and gas reserved by the lessor, is in direct conflict with principles established by decisions of the Supreme Court in *Burnet* v. *Harmel*, 287 U. S. 103; *Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312; *Herring* v. *Commissioner*, 293 U.

S. 322; and *Douglass* v. *Commissioner,* 322 U. S. 275. The Supreme Court in those cases decided, in so far as the lessor is concerned, that a payment as bonus or advance royalty is "payment for the oil and gas to be extracted"; that said payments made by the lessee to the lessor are ordinary income to the lessor and not proceeds of a sale of capital investment; and that the lessor is entitled to depletion on said bonus or advance royalty because this constitutes part of the lessor's share of the "gross income from the property." The Supreme Court has not directly dealt with the status for tax purposes of such bonuses or advance royalties from the standpoint of the lessee.

### *Conclusion.*

The questions involved are both of great public importance in the administration of the Revenue Acts. The conclusions reached by the Circuit Court of Appeals conflict in vital respects with several decisions of this Court, and we think are in conflict with the decisions of other Circuit Courts of Appeals.

It is, therefore, respectfully submitted that the petition be granted.

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